

No. 12433

United States
Court of Appeals
for the Ninth Circuit.

FIRST NATIONAL BENEFIT SOCIETY,
a Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

Petition to Review a Decision of the Tax Court
of the United States

FILED

APR - 5 1950

PAUL P. O'BRIEN,

CLERK

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES

For Petitioner:

ROBERT R. WEAVER, Esq.

For Respondent:

L. C. AARONS, Esq.

Docket No. 14661

FIRST NATIONAL BENEFIT SOCIETY, a
Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1947

June 9—Petition received and filed. Taxpayer notified. Fee paid.

June 9—Request for hearing at Los Angeles, Calif., filed by taxpayer. 6/23/47 Granted.

June 12—Copy of petition served on General Counsel.

July 3—Amended petition filed by taxpayer. Copy served 7/8/47.

July 22—Entry of appearance of Robert R. Weaver, as counsel, filed.

Aug. 27—Answer to amended petition filed by General Counsel.

Sept. 2—Copy of answer served on taxpayer. Los Angeles, Calif., calendar.

1948

Sept. 23—Hearing set November 29, 1948 at Los Angeles, California.

1948

Nov. 30—Hearing had before Judge Van Fossan on merits. Stipulation of facts with joint exhibits 1-A, 2-B and 3 thru 9, attached thereto, filed at hearing. Briefs due 1/14/49. Replies due 1/31/49.

Dec. 21—Transcript of hearing 11/30/48 filed.

1949

Jan. 12—Brief filed by taxpayer. 1/18/49 Copy served.

Jan. 17—Motion for leave to file the attached reply brief, brief lodged, filed by General Counsel. 1/18/49 Granted.

Feb. 1—Motion for leave to file the attached brief, reply brief lodged, filed by General Counsel. 2/2/49 Granted.

Feb. 3—Motion for leave to file the attached reply brief, reply brief lodged, filed by taxpayer. 2/3/49 Granted.

Feb. 4—Copy of motion and reply brief served on General Counsel.

Sept. 13—Memorandum findings of fact and opinion rendered, Judge Van Fossan. Decision will be entered for the respondent. Copy served.

Sept. 13—Decision entered. Judge Van Fossan. Div. 9.

Nov. 29—Bond in the amount of \$2,271.66 approved and ordered filed.

1949

Nov. 29—Petition for review by U. S. Court of Appeals, 9th Circuit, with assignments of error filed by taxpayer.

Nov. 29—Proof of service filed by General Counsel.

Nov. 29—Designation of record for the complete record and all the proceedings and evidence filed by taxpayer.

Nov. 29—Affidavit of service by mail of designation of record filed. (Also request for preparation.)

The Tax Court of the United States

Tax Court Docket No. 14661

FIRST NATIONAL BENEFIT SOCIETY, a
Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

AMENDED PETITION

The above named Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (LA:90D:PAK) dated the 14th day of March, 1947, and as a basis for its proceeding alleges as follows:

I.

1. The Petitioner is a Corporation, organized and existing under and by virtue of the laws of the State of Arizona, and during the year 1939, the fiscal tax year involved herein was authorized to and was transacting business in said State under the provisions of the Arizona laws 1937, Ch. 36 #1, p. 107 (Sections 53-601 to 53-622 1939 Ariz. Code Anno.).

2. The return for the period herein involved was filed with the Collector for the District of Arizona and involves Federal Income Taxes.

3. The Post Office address of Petitioner is 807 West Washington Street, Phoenix, Arizona.

II.

1. The amount of the deficiency determined by the Commissioner is \$1,135.83 for income tax for the year 1939. The Petitioner's Return was filed with the Collector for the District of Arizona, and covered its income taxes for the year ending December 31, 1939.

2. The Notice of deficiency, a copy of which is hereto attached, marked Exhibit A, was mailed to the Petitioner on March 14, 1947.

III.

Assignment of Errors

The determination of the tax set forth in said

Notice of Deficiency is based on the following errors:

1. The Commissioner determined that compensation due M. C. Reese, accruing under an employment contract, during the year 1939, but not paid during that year was not deductible. Such determination was erroneous for the reason that although Petitioner filed its return on a cash basis, the Commissioner for the purpose of determining Petitioner's taxes for the said year actually accrued claims, where deaths had been reported but were paid during the following year, and this determination leaves the calculation partially on an accrual basis and partially on a cash basis.

2. The Commissioner determined that the sum of \$4,518.71 was not deductible from Petitioner's income during the said period. Such determination was erroneous, for the reason that whether Petitioner is to be classified as a Life Insurance Company under the Provisions of Sec. 201 of the Internal Revenue Act, as it contends, or to be classified as an Insurance Company other than life, under the provisions of Sec. 207 of said act, as it is classified by Commissioner it would be entitled to a deduction, even under Sec. 207 of the Internal Revenue Act as of that year from the net addition required by law to be made within the taxable year to reserve funds. (Sec. 207) (c) (1) (A) Internal Revenue Act 1939).

3. The determination of the deficiency was also

in error, for the reason that although he had classified the Petitioner under 207 of the Internal Revenue Act as effective during the year 1939, he did not deduct those funds created by premium deposits, for the payment of expenses and losses as provided in said Section (Section 207) (c) (3).

4. The Commissioner erred in its classification of the Petitioner for the reason that the said Petitioner was during the year 1939 a Life Insurance Company, more than fifty percentum of its reserves being held for the fulfillments of its life insurance contracts.

STATEMENT OF FACTS

Preliminary Statement

1. Referring to assignments of Error No. 1, the Petitioner filed its income tax return for the year 1939 made out on a cash basis. However, the Commissioner in determining the amount of Petitioner's tax liability, chose to accrue the claims paid in the early part of 1940 where the deaths had occurred in the latter part of 1939. This procedure had been followed in regard to Petitioner's 1938 income taxes, thus placing the taxpayer in that regard on an accrual basis. This accrual of such items coupled with a failure to accrue the item of \$3,675.41 payable to M. C. Reese during that year but not paid does not furnish the true net income figure for the purpose of levying an income tax. Further it does not give the true balance as between those reserves

held for the fulfillment of Petitioner's Life Insurance contracts for the purpose of classification. The Commissioner in his notice of deficiency mailed to petitioner on March 14, 1947, and as an explanation of his determination makes the following statement:

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated April 6, 1942 to your protest dated May 1, 1942 and to the statement made at conferences held.

Your contention that you should be classified as a life insurance company under the provisions of section 201 of the Internal Revenue Code is denied. It is held that you are a mutual insurance company subject to tax under the provisions of section 207 of the Internal Revenue Code.

With the above as the basis for the deficiency, the following statements referring to the above assignments of error, #1:

1. After the Commissioner had made an audit accruing the items above referred to, an audit was made by Joe L. Schmitt, Jr., who is the chief examiner for the Arizona Insurance Department, accruing the other items on petitioner's books in like manner, which audit was forwarded to the Commissioner on June 9, 1946.

2. Referring to assignments of Error No. 2, the Arizona law under which Petitioner was transacting its business during the year 1939, requires a deposit with the State Treasurer (Sec. 53-605 1939 Ariz. Code Anno.) which under the provisions of

Section 207 of the Internal Revenue Act is a deductible item for the year in which it was deducted, even if it did not classify as a life insurance reserve for the purpose of classification of Petitioner's business for taxation purposes. The amount so deposited during the year 1939 was \$4,518.71, which amount was not allowed as a deductible item by the Commissioner in determining the tax deficiency herein referred to.

3. Referring to assignments of Error No. 3, in determining the said deficiency, the Commissioner classified the Petitioner under Section 207 of the Internal Revenue Code, and although he sets up in one item an expense already incurred, (the amount due M. C. Reese), he not only did not deduct it for the purpose of his determination but he made no allowances for it or for any expense under the provisions of Section 207 (c) (3) of the Internal Revenue Code. The Petitioner is a Mutual, Non-Profit organization and is not authorized by law to collect premiums (and does not collect them) for any other purpose than that of paying expenses and losses, and building the necessary reserves for the fulfillment of its *contacts*.

4. Under the law of the State of Arizona and the operations of the Petitioner together with the condition of its reserves, Petitioner should be classified as a life insurance company under the provisions of Section 201 of the Internal Revenue Code, as it existed during the year 1939 more than fifty percentum of its reserves were held for the fulfill-

ment of its contracts, the procedure adopted by the Commissioner; that is, the accrual of claims where deaths had occurred late in December, 1939 and paid early in the year, 1940, together with the failure to accrue expense items already incurred, does not give the true balance of reserves held by petitioner for the purpose of determining whether or not more than fifty percentum of its reserves were held for the fulfillment of its life insurance contracts. Petitioner does nothing but a life insurance business. Its reserves are calculated on a basis equivalent to the American experience table of mortality plus $3\frac{1}{2}\%$. Its mortuary reserve is held under requirements of the law of the State of Arizona and rules of the corporation commission authorized thereby. The reserve so calculated and set aside by the corporation for the fulfillment of its life insurance contracts and used for no other purpose, constitute more than fifty percentum of its total reserve funds.

Wherefore, Petitioner prays that this court may hear this proceeding and set aside and annul the purported deficiency or grant such other relief as may be found proper.

FIRST NATIONAL BENEFIT
SOCIETY,

By /s/ M. C. REESE,
President.

807 West Washington St.,
Phoenix, Arizona.

State of Arizona,
County of Maricopa—ss.

M. C. Reese, being first duly sworn, deposes and says: I am the President of the First National Benefit Society, the petitioner in whose behalf the foregoing petition is filed and I am duly authorized to verify the foregoing petition; that I have read the foregoing petition, and am familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those I believe to be true.

/s/ M. C. REESE.

Subscribed and sworn to before me this 30th day of June, 1947.

[Seal] /s/ K. ALMIRA HAMMOND,
Notary Public in and for the County of Maricopa,
State of Arizona.

My Commission Expires Sept. 30, 1950.

EXHIBIT A

Form 1279

SN-IT-7

Treasury Department
Internal Revenue Service
417 South Hill Street
Los Angeles 13, California

Office of
Internal Revenue Agent in Charge
Los Angeles Division
LA:IT:90D:PAK

Mar. 14, 1947

First National Benefit Society
First National Bank Building
Phoenix, Arizona

Gentlemen:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1939 discloses a deficiency of \$1,135.83, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward

it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your return (x) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSE D. NUNAM, JR.,

Commissioner,

By GEORGE O. MARTIN,

Internal Revenue Agent
in Charge.

Enclosures:

Statement

Form of Waiver

Statement

LA:IT:90D:PAK

First National Benefit Society

First National Bank Building

Phoenix, Arizona

Tax Liability for the Taxable Year

Ended December 31, 1939

Income Tax

Liability \$1,135.83

Assessed \$—0—

Deficiency \$1,135.83

In making this determination of your income tax liability, careful consideration has been given to the

report of examination dated April 6, 1942, to your protest dated May 1, 1942 and to the statements made at conferences held.

Your contention that you should be classified as a life insurance company under the provisions of section 201 of the Internal Revenue Code is denied. It is held that you are a mutual insurance company subject to tax under the provisions of section 207 of the Internal Revenue Code.

Adjustment to Net Income

Net Income as disclosed by return.....	None
Additional income:	

(a) Net income as disclosed by books.	\$6,883.83
---------------------------------------	------------

Net income adjusted	\$6,883.83
---------------------------	------------

Explanation of Adjustment

(a) An examination of your books and records discloses taxable net income for the year 1939 in the amount of \$6,883.83 as compared with the amount of \$1,965.37 which you contend is correct on the basis of the audit report submitted by you. The difference amounting to \$4,918.46 is reflected in the following items:

Items deducted in computing net income shown in your audit report not deductible for income tax purposes:

(a) Compensation under M. C. Reese

Contract	\$3,675.41
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(b) Amount deposited with State

Treasurer	4,518.71
-----------------	----------

(c) Accrued Losses (claims) December
31, 1939 47.34

\$8,241.46

(d) Less: Accrued losses (claims) Decem-
ber 31, 1938 overstated in your audit
report 3,323.00

Difference as shown above.....\$4,918.46

(a) Compensation Under M. C. Reese
Contract—\$3,675.41

The amount claimed as a deduction in your audit report as compensation due M. C. Reese under an alleged employment contract amounts to \$18,075.41. The amount actually paid Mr. Reese during the year under said alleged contract amounted to \$14,400.00; the difference, \$3,675.41, is disallowed for the reason that your books and records are on the cash basis of accounting.

(b) Amount Deposited with State
Treasurer—\$4,518.71

The amount, \$4,518.71, deposited with the Arizona State Treasurer during the taxable year does not constitute additions required by law to be made within the taxable year to reserve funds within the meaning of section 207 of the Internal Revenue Code and therefore is not a proper deduction in computing your taxable net income under that section of the Act.

(c) Accrued Losses (Claims) at December 31,
1939—\$47.34

The amount of accrued losses (claims) at December 31, 1939 shown in your audit report at \$4,299.99 has been reduced to \$4,252.65. The balance, \$47.34, has not been substantiated as proven claims.

(d) Accrued Losses (Claims) at December 31,
1938—\$3,323.00

The amount of accrued losses (claims) at the beginning of the taxable year 1939, shown in your audit report at \$5,155.49, has been reduced to \$1,832.49, the amount reflected in the computation of your taxable net income for the preceding taxable year 1938 as accrued losses (Claims) at the close of that year.

Computation of Income Tax

Net income adjusted.....	\$6,883.83
Special class net income.....	\$6,883.83
Income tax:	

161½% of \$6,883.83	\$1,135.83
---------------------------	------------

Correct income tax liability.....	\$1,135.83
-----------------------------------	------------

Income tax assessed:

Original, account No. 850002.....	—0—
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Deficiency of income tax.....	\$1,135.83
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Copy served July 8, 1947.

Filed July 3, 1947, T.C.U.S.

[Title of Tax Court and Cause.]

ENTRY OF APPEARANCE

The undersigned, being duly admitted to practice before The Tax Court of the United States as Attorney ~~C. P. A.~~, * * * herewith enters his appearance for the petitioner in the above-entitled proceeding.

/s/ ROBERT R. WEAVER,
403-404 First National Bank
Bldg., Phoenix, Arizona.

* * * Cross out qualification
class not applicable.

Served.

Received and filed July 22, 1947.

[Title of Tax Court and Cause.]

ANSWER TO AMENDED PETITION

The Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, for answer to the amended petition of the above-named taxpayer, admits and denies as follows:

I.

1. Admits that Petitioner is a Corporation, organized and existing under and by virtue of the laws of the State of Arizona, and during the year 1939, the fiscal tax year involved herein, was author-

ized to and was transacting business in said State. Denies the remainder of the allegations contained in paragraph 1 of section I of the amended petition.

2 and 3. Admits the allegations contained in paragraphs 1 and 2 of section I of the amended petition.

II.

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of section II of the amended petition.

III.

1. Admits that the Commissioner determined that compensation of M. C. Reese, under an employment contract, during the year 1939, and not paid during that year was not deductible. Denies, however, that such determination was erroneous and denies the remainder of the allegations contained in paragraph 1 of section III of the amended petition.

2. Admits that the Commissioner determined that the sum of \$4,518.71 was not deductible from petitioner's income during the said period. Denies, however, that such determination was erroneous and denies the remainder of the allegations contained in paragraph 2 of section III of the amended petition.

3 and 4. Denies the allegations contained in paragraphs 3 and 4 of section III of the amended petition.

Statement of Facts

Preliminary Statement

1. Admits that the petitioner filed its income tax return for the year 1939 on a cash basis. Denies the remainder of the allegations contained in paragraph 1 of the Preliminary Statement of Statement of Facts appearing on page 4 of the amended petition.

1 and 2. Denies the allegations contained in paragraphs 1 and 2 of the Preliminary Statement of Statement of Facts appearing on page 5 of the amended petition.

3. Admits that the Commissioner classified the Petitioner under Section 207 of the Internal Revenue Code. Denies that remainder of the allegations contained in paragraph 3 of the Preliminary Statement of Statement of Facts of the amended petition.

4. Denies the allegations contained in paragraph 4 of the Preliminary Statement of Statement of Facts of the amended petition.

IV.

Denies each and every allegation contained in the amended petition not hereinbefore admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ CHARLES OLIPHANT,
Chief Counsel,
Bureau of Internal
Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

E. A. TONJES,
A. J. HURLEY,
Special Attorneys,
Bureau of Internal Revenue.

Received and filed Aug. 27, 1947.

[Title of Tax Court and Cause.]

SERVICE OF ANSWER AND NOTICE OF
PLACE OF HEARING

Service Is Hereby Made of Answer.

Notice of time of hearing at Los Angeles, California or vicinity will be sent when proceeding is calendared for hearing on merits.

/s/ VICTOR S. MERSCH,
Clerk.

To: Robert R. Weaver, Esq.,
403-404 First National Bank Bldg.,
Phoenix, Arizona.

Sept. 2, 1947.

[Title of Tax Court and Cause.]

NOTICE OF SETTING PROCEEDINGS FOR
HEARING—CIRCUIT CALENDAR

September 23, 1948.

Take Notice that a Division of The Tax Court of the United States will sit in Room 229, U. S. Post Office & Court House, beginning November 29, 1948, Los Angeles, Calif.

Hearings will be held in all proceedings shown on the attached list. The list will be called promptly at 10:00 a.m., as indicated, and you will be expected to answer the call at that time and be prepared for trial when reached. No continuance will be granted except for extraordinary cause. Failure to appear will be taken for cause for dismissal in accordance with the Rules of Practice, and you are in all other respects expected to be familiar with such rules.

Respectfully,

/s/ VICTOR S. MERSCH,
Clerk.

To: Robert R. Weaver, Esq.,
403-404 First National Bank Bldg.,
Phoenix, Arizona.

[Title of Tax Court and Cause.]

MINUTES OF PROCEEDINGS

Date: November 30, 1948.

Place: Los Angeles, Calif.

Docket No. 14661.

Proceeding: First National Benefit Society, a Corp.

Assigned to: Judge Van Fossan.

On the merits: Yes.

On motion of.....

Ordered:

Filed at hearing: Stipulation of facts with Joint Exhibits 1-A and 2-B, and petitioner's exhibits 3 thru 9.

Petitioner's brief: Jan. 14, 1949.

Respondent's brief: Jan. 14, 1949.

Replies: Jan. 31, 1949.

Witnesses for Petitioner: M. C. Reese, D. A. Harper.

Exhibits:

Petitioner's: 10. Statement.

Respondent's: C. Corp. income & excess profits tax ret. 1939. D. Individual income tax return—Melvin C. Reese—1939.

/s/ MARY Y. ROBERTS,
Acting Deputy Clerk.

The Tax Court of the United States

Docket No. 14661

FIRST NATIONAL BENEFIT SOCIETY, a
Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Before: Ernest H. Van Fossan,
Judge.

Appearances:

ROBERT R. WEAVER,
403-4 First National Bank Building,
Phoenix, Arizona,
Appearing for the Petitioner.

L. C. AARONS,

(HONORABLE CHARLES OLIPHANT,

Chief Counsel,
Bureau of Internal Revenue),
Appearing for the Respondent.

PROCEEDINGS

The Court: Call the next case.

The Clerk: Docket No. 14661, First National
Benefit Society.

Mr. Aarons: L. C. Aarons for the Respondent.

Mr. Weaver: Robert R. Weaver for the Petitioner.

The Court: You may state the issues.

Opening Statement on Behalf of the Petitioner
By Mr. Weaver

Mr. Weaver: The issues here are in brief, first, that the Commissioner should have allowed a deduction in the form of accrued but not paid salary of one of the executive officers, having accrued certain claims upon which proof had not yet been made that the other should have also been accrued. Also, that if Commissioner is to classify this company under Section 207 of the Internal Revenue Act, he should have allowed a deduction under 207(C) 1(a). Also, that in the event of classification under 207, that a deduction should have been allowed under 207(3)(c) and 4; that we contend the classification should not have been 207, but should have been classified under 201 of a life insurance company.

If the Court please, we have entered into a stipulation setting out, I believe, nine exhibits which to a large extent show the transactions of this company very completely. I now offer in evidence this stipulation with the attachments.

The Court: We will wait for the opening statements before we receive the exhibits.

Will you state your issues, Mr. Aarons?

Opening Statement on Behalf of the Respondent
By Mr. Aarons

Mr. Aarons: If the Court please, I think it may be helpful to expand just a bit upon Petitioner's statement of the issues.

Section 201 of the Revenue Act, 1938, classifies certain companies as life insurance companies, for purposes of income taxation.

Section 207 relates to mutual companies, other than life insurance companies.

The Commissioner has classified Petitioner as a 207 rather than a 201 corporation. Section 201, as it has stood substantially since 1921, is based upon the theory that the true income of life insurance companies is their investment income, that is, income from rents and dividends and interest, and that is the bases upon which life insurance companies, true life insurance companies are taxed, and in order to qualify as true life insurance companies, the statute and regulations require that true life insurance reserves be maintained, reserves as defined in Section 203 of the Regulations.

Now, this company, as is stipulated, has no investment income. So, the burden is upon the Petitioner to show how its reserves may be classified as true life insurance company reserves, under 201, and how it may be classified under that section, even though it has no investment income, which is the sole basis for tax under 201.

That issue, besides the other three issues, are that,

assuming the Petitioner is classifiable as a 207 company rather than a 201, is it entitled to certain deductions? One of the issues of those three is whether or not the amount deposited by Petitioner with the State Treasurer or Arizona is an addition to reserve of the type which is deductible under Section 207.

The Respondent claims that it is not of the type which is referred to specifically in Section 207.

Another one of the three subsidiary issues is whether the Petitioner is entitled to approve the salary which was due and owing to its president, Mr. Reese, even though and notwithstanding the fact that the Petitioner filed its returns on a cash basis. Petitioner contends in that regard that because the Commissioner treated one item, namely, claims paid on an accruable basis, that, therefore, the Petitioner can take advantage of that and have the salary of Mr. Reese deducted on an accruable basis, also.

The last of the specific items, on the assumption that the company is a 207 company, is an unspecified one in the petition, and I do not know exactly what Mr. Weaver plans to introduce. I will say only that the Respondent contends that the Petitioner has been allowed every deduction authorized by the statute.

Now, as further background for this case, I would like to point out that there have been **two** previous cases, starting in the District Court, going through the Circuit Court of Appeals for the Ninth

Circuit, with certiorari denied in the Supreme Court, involving this company and the United States. The first case involved the tax years of 1936 and 1937, and the second one involved the year of 1938. The Respondent will contend that those cases, both resulting in determinations in favor of the government, are controlling in this case.

The Court: You may proceed, Mr. Weaver.

Mr. Weaver: If the Court please, since counsel has gone into some of the law, might I make a few statements in the way of a statement?

The Court: You may.

Mr. Weaver: 201, Section 201 of the Internal Revenue Act, as it existed in 1939, provided that a company issuing life insurance or combined life, health and accident insurance, more than 50 per cent of whose reserves were held for the fulfillment of such contracts, was a life insurance company. The regulations, the Treasury Department Regulations, where the provisions are found that it must be a life insurance reserve within the meaning that it is calculated on a definite basis with an interest increment and a technical reserve. There has been a disagreement as to the validity of those.

However, it was decided, as counsel said, in this Circuit, in our case first, that we were not a life insurance company under our law as it existed.

You see, the regulations required that these reserves be required by law. That is not in the code

section, the Internal Revenue Code Section, so we were operating under a law in Arizona, which was changed when we came up with the second case.

But in the second case there was no decision, except that we had not borne the burden of proof that we were a life insurance company. So, I don't see how it could be *res judicata*, but now we are proceeding on a later year. We wish to raise different points that we never raised before, in regard to the matter of whether or not the company is a life insurance company, and the last decision merely said we had not borne the burden of proof, that it was a life insurance company.

As I say, there is a disagreement. I think five other Circuits have held this type of company were life insurance companies, and so we contend that we are a life insurance company. I believe that our specifications here set out the sections under 207, under which we would be entitled to a deduction if we were classified as a 207.

The Court: You have stipulated as to the facts in the case, have you?

Mr. Weaver: We have stipulated as to all the records. We have introduced the records which show the method of operations, how the reserves were kept, how they were transferred, and all those matters in regard to reserves. They are fully stipulated by stipulation, the introduction of these matters in evidence, and I think this case is 95 per cent in the stipulation we have here.

The Court: What is your testimony?

Mr. Weaver: The only testimony, there are certain items that I wish to introduce testimony in regard to.

The Court: You may introduce the stipulation. The stipulation is duly signed by both parties?

Mr. Weaver: Yes, sir.

The Court: The stipulation will be received. You may proceed with the testimony.

Mr. Weaver: Mr. Reese, will you take the stand?

Whereupon,

M. C. REESE

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name, please.

The Witness: M. C. Reese.

Direct Examination

By Mr. Weaver:

Q. Mr. Reese, are you an officer of the First National Benefit Society? A. Yes, sir.

Q. What is your office?

A. I am entitled president.

Q. When was the company organized?

A. March, 1934.

Q. And you were its president at that time?

A. Yes, sir.

Q. And have been ever since? A. Yes, sir.

Q. Now, after having built up certain reserves,

(Testimony of M. C. Reese.)

have you now changed your operations? What I mean is, have you changed over from a mutual benefit society now?

A. The First National Benefit Society was reinsured by the First National Life Insurance Company, a legal reserve company.

Q. And that was in what year?

A. In March, 1947.

Q. This life insurance company has assumed the assets and the liabilities of the Benefit Society?

A. The life insurance company assumed the assets and liabilities of the Benefit Society by means of equitable distribution of the assets of the First National Benefit Society to the policyholders.

Q. Well, it assumed it by a contract, did it not?

A. And the distribution of assets.

Q. Now, it assumed also its tax liability, the same as everything else?

A. It also assumed the tax liability.

Q. In the organization, was the stock of the new company distributed to the members in proportion to the amount of their premium?

A. The entire stock was divided to all the policy holders on an equitable basis.

Q. What was that basis?

A. That basis was one share for each dollar per month premium which they paid to the company in premiums.

Q. So that the new company is owned by the

(Testimony of M. C. Reese.)

former policy holders that owned the Benefit Society? A. They are identical in ownership.

Q. The deposit with the State was taken out of the general expense fund of the Benefit Society; is that right?

A. The new deposit with the State was taken from the expense fund of the Benefit Society.

Q. What was the amount of that?

A. The amount was \$100,000.00.

Q. Now, this company was organized under the provisions of the law, as it existed in 1934. Was that Section 607, and following, in the 1928 Code?

A. It was organized under the law as it existed in 1928, organized in 1934, and operated after 1937 under the amended law of 1937.

Q. It was as stipulated, operating under the law as amended in 1937? A. That is correct.

Q. During the year in question, 1939?

A. That is correct.

Q. Now, during the life of this Benefit Society, of its business, was there ever any other item except the payment of death claims charged to the mortuary account?

A. No, sir, with one exception, on a '37 case, when they threatened to attach the mortuary money. I paid the tax out of the mortuary money, because that is where the money was.

Q. When the government was going to levy on it, you paid it out of there?

A. And that was subsequently replaced.

(Testimony of M. C. Reese.)

Q. Subsequently replaced in the mortuary fund?

A. Yes.

Q. In the exhibits in evidence here, there shows a \$6,500.00 asset in the form of a deposit on a bond. Would you explain what that is?

A. That was a deposit to secure a lower court judgment on a claim on an appeal case, which was returned to us later on.

Q. The \$6,500.00? A. \$6,500.00.

Q. The \$6,500.00 was returned and placed back in the funds of the Society?

A. Of the company, yes.

Q. I notice in some of the earlier—according to the exhibits on file—some of the early policies, there was a provision that expenses, attorneys' fees and expenses, of defending the fund could be charged to the mortuary fund. Was that ever done?

A. No, sir, that was never done. The wording of the policy was that the reserve, the specified portion of the premiums were set aside for the reserve, for the purpose of payment of claims and incidentals thereto. However, that was taken out by amendment to the by-laws in 1937.

Q. And during 1938 and 1939, the provisions of your by-laws forbid even charging the expense of the defendant—

Mr. Aarons: If I may interrupt, I feel I must object, because the by-laws are in evidence and they speak for themselves.

Mr. Weaver: I will withdraw the question.

(Testimony of M. C. Reese.)

Q. (By Mr. Weaver): Now, there is an exhibit in the stipulation, Mr. Reese, showing the 12 monthly sheets, monthly recapitulation sheets of your receipts ledger. These receipts, these pages showing a portion of the detailed receipts and the monthly recapitulation and transfer to reserves?

A. Yes.

Q. I am referring to Petitioner's Exhibit 4 under the stipulation. It shows on these receipts certain detailed transactions prior to the recapitulation entries. Are these the daily entries of these funds, of these receipts into the different funds?

A. Daily receipts are separated; 50 per cent to the expense fund and 50 per cent to the reserve fund, as per each individual certificate or each individual payment.

Q. Each individual payment of a premium is entered separately and allocated to the different funds on that receipts ledger. Is that right?

A. Yes.

Q. And those are the detailed information, a part of which shows on the recapitulation sheet each month, which is in evidence? A. Yes.

Q. And the ledger contains about how many pages, the ledger itself?

A. The daily entry pages for the year 1939 was 2,800 pages, 144,000 entries.

Q. But the type of entry is shown just above the recapitulation entries on each of these 12 sheets for each month? A. Yes.

(Testimony of M. C. Reese.)

Q. Now, in the Exhibit No. 1, under the stipulation, which shows the articles of incorporation and by-laws, these by-laws, do they set up these dues and assessments, premiums, on a basis of dues and assessments?

Mr. Aarons: I must object again. The by-laws speak for themselves.

Mr. Weaver: Yes. I will withdraw that. It is shown by the by-laws.

Q. (By Mr. Weaver): What was your basis of calculating this premium from the standpoint of reserves and premiums?

A. The estimated basis of calculating the cost of life insurance on these particular forms was according to U. S. death mortality rates.

Q. Then, you had set up a certain amount as advance assessment and a certain amount as dues added to it?

A. We set up a certain amount as advance assessment and a certain amount to cover operating expenses, still with the right of assessment.

Mr. Aarons: I object, if the court please. The statement that the Petitioner had the right of assessment is a conclusion of law, which may be an important issue in this case, and I object to it as being incompetent, on the ground it is a conclusion of law.

Mr. Weaver: Well, it is specifically given the right of assessment in the by-laws. The by-laws specifically provide for the matter of assessment.

(Testimony of M. C. Reese.)

The Court: Will the reporter read the question, please.

(The question was read.)

The Court: I will have to ask the reporter to read the question again. I do not understand it.

(The question was reread.)

Mr. Aarons: May I expand, if the court please, on my objection. The statute, Section 207(C), under which Section 207 the Respondent is classifying the Petitioner, provides for certain deductions for mutual companies, and one of the deductions is the net addition required by law to be made within the taxable year to reserve funds, included in the case of assessment insurance companies the actual deposit of sums with state or territorial officers, pursuant to law, adds to guarantee or reserve funds.

Now, it may be that it is important to determine in this case whether this company is an assessment company, and on that point, I object to the witness classifying the company in any way as an assessment company, because I believe the determination of that may be drawn entirely from the by-laws and from the policy contracts themselves, which are in evidence.

The Court: Any characterization by the witness will not be binding on the court. He may answer.

Mr. Weaver: It was answered, if the Court please. I believe that is all. Your witness.

The Court: You may inquire.

(Testimony of M. C. Reese.)

Cross-Examination

By Mr. Aarons:

Q. Mr. Reese, you stated that in March, 1947, the company changed over to a legal reserve company.

A. I stated that the First National Life Insurance Company assumed the liability and assets of the First National Benefit Society, and we signed the consent. Even this case should be the First National Life Insurance, assuming the liability.

Q. Well, your company—is the Petitioner now a legal reserve company?

A. The Petitioner is now a legal reserve company, the First National Life Insurance Company, but not the First National Benefit Society.

Q. Will you explain what the difference is to me, who is not too familiar with insurance technicalities, the difference between a legal reserve company and the type of company that yours was in the taxable year of 1939?

A. A legal reserve company, they compute their rates upon an adopted mortality table, writing various forms of investment insurance, giving extended insurance values, cash values, loan values, and so forth, with an interest increment added to that reserve each year, loading the premium from the net cost of the insurance to the selling cost, which is the expense operation of the company.

Now, an assessment company is a mutual company which cannot grant loan values and free insurance or extended insurance for a period of time,

(Testimony of M. C. Reese.)

and they are supposed to operate as a mutual company and be owned by the policy holders, and not as a proprietary institution. Therefore, in view of the fact they cannot grant loan values and give cash values, extended insurance values, their rates would normally be lower, but being covered under the laws, as they exist, any mutual company does have the right of assessment, whereas a legal reserve company does not have the right of assessment, a stock company.

Q. While we are on that subject of assessment, Mr. Reese, I would like to show you a specimen copy of a property floater policy of the Central Manufacturers' Mutual Insurance Company of Van Wert, Ohio.

Now, Article 10 of that policy is headed, "Non-assessable Policies." It reads: "No member shall be liable for losses or expense or any indebtedness of the company, except to the extent of the premiums paid. All policies of this company shall be without assessment and liability whatsoever."

A. Is this a reciprocal?

Q. I would like you to examine that policy and tell the Court whether you think it is an assessable policy.

Mr. Weaver: If the Court please, I object.

The Witness: I will answer it for you.

Mr. Weaver: I will withdraw the objection.

The Witness: If they have a deposit with the state of Illinois, and if that deposit becomes im-

(Testimony of M. C. Reese.)

paired, they place a lien against the policy, and *the* pay the losses on a provided basis and the company will fold up, the same as any mutual legal reserve life insurance company.

Mr. Aarons: I would like to offer this specimen policy of the Central Manufacturers' Mutual Insurance Company in evidence as Respondent's exhibit.

Mr. Weaver: I object to it as not tending to prove any of the issues in this case, and it has nothing to do with this company.

The Court: I don't believe it will add any evidence in this case.

Mr. Aarons: If the Court please, the witness has testified, or has attempted to show, that Petitioner's policies are assessable. They contain language almost identical to the language which I read from this specimen policy of another company, and that paragraph headed, "Non-assessable," I believe it has some probative force.

The Court: I sustain the objection.

Q. (By Mr. Aarons): Mr. Reese, I show you what purports to be the corporation income and excess profit tax return of the First National Benefit Society for the year 1939, and ask you whether this is your signature.

A. This top signature is my signature.

Mr. Aarons: Without objection, I wish to offer this return as Respondent's Exhibit C.

Mr. Weaver: No objection.

The Court: Are Exhibits A and B attached to the stipulation?

(Testimony of M. C. Reese.)

Mr. Aarons: Yes, your Honor, joint Exhibits 1-A and 2-B are attached to the stipulation.

The Court: This is Exhibit C.

(The document above-referred to was received in evidence and marked Respondent's Exhibit No. C.)

Q. (By Mr. Aarons): Mr. Reese, I show you what purports to be an individual income tax return, 1939, for Melvin C. Reese, and ask you whether this is your signature at the end of the return.

A. Yes, sir, that is my signature.

Mr. Aarons: If the Court please, I offer the individual tax return for 1939 of Melvin C. Reese as Respondent's Exhibit D.

Mr. Weaver: I have no objection.

The Court: Exhibit D in evidence.

(The document above-referred to was received in evidence and marked Respondent's Exhibit No. D.)

Q. (By Mr. Aarons): Mr. Reese, would you state how many bank accounts were maintained in 1939 by the Petitioner? A. One bank account.

Q. And in that account were all of the receipts placed that were received by the company?

A. Yes, sir.

Q. That is, there was no attempt to segregate as separate funds the reserve for expenses and the mortuary reserve?

(Testimony of M. C. Reese.)

A. The books separated the money, although the money was in one place.

Q. The actual segregation, therefore, is shown only on the books of the corporation?

A. Yes, sir.

Q. Your books, Mr. Reese, are maintained on a cash basis; is that correct?

A. Yes, sir, they are maintained on a cash basis.

Q. And your return, which is in evidence, shows that it is filed on a cash basis? A. Yes, sir.

Q. You stated something, I believe, about the basis upon which the amount of the premiums charged in 1939 were calculated. Is it correct that 50 per cent of the premiums were supposed to go into the mortuary reserve, and that on the basis of the American experience mortality table, that is, speaking of 1939, were 3½ per cent assumed rate of interest, that those premiums were supposed to be sufficient to cover your claims?

A. No. I stated that according to the U. S. table of mortality, which is an accurate table of mortality, that the amount apportioned to pay those losses was sufficient to pay those losses as they arose.

Q. Well, is there an assumed rate of interest in that table of mortality, of which you are speaking?

A. Not on an assessment insurance. There couldn't be, not even in the U. S. mortality table. It is a current death rate.

Q. Mr. Reese, in the previous case involving the year 1948, Amos A. Betts, a member of the Arizona

(Testimony of M. C. Reese.)

Corporation Commission, testified that the requirements of the Arizona Commission were that an amount had to be set aside in reserve, which would be equivalent to or approximately the same as the American table of mortality experience, which would be $3\frac{1}{2}$ per cent. Was that testimony incorrect?

A. Mr. Betts is deceased. He was not an insurance man. He was a utility man. However, in the determination of rates of insurance, a 1-year term rate has no interest increment or a group life insurance rate has no interest increment. Still it is on a mortality table, or an estimated mortality table, which would be the equivalent to a mortality table. The step-rate term plan has no interest increment.

Q. Has your annual income always been sufficient to meet the total amount of claims maturing each year? A. Up to date.

Q. Actually are not your premiums sufficiently large or perhaps loaded, as they say in insurance terminology, to make it possible so that each year, excepting for some unexpected catastrophies, the annual income equals the annual outgo, at least equals the annual outgo?

A. The 16 years' operation shows an excess savings in mortality funds of \$120,000, with \$1,300,000 disbursed out in death claims.

Q. What is the total amount of insurance which was outstanding, which had been issued by your company and which was outstanding at the end of the year, the year of 1939?

(Testimony of M. C. Reese.)

A. The total amount of insurance which was outstanding, exposure, on the greatest basis, the policy graded the first year, was four million and a half.

Q. Now, in the balance sheet, which is attached to your income tax return for the year 1939, that is the Petitioner's income tax return, the liabilities are shown as depreciation for furniture and fixtures, two hundred thirty-nine dollars and some-odd cents; expense funds, thirty-one hundred seventy-three dollars and some-odd cents; benefit funds, sixteen thousand four hundred eighty dollars and some-odd cents. You say you had over four and one-half million dollars of insurance outstanding at the end of that year; is that correct?

A. Yes, with no other than current losses against it.

Q. So that the current losses, so long as they did not overbalance the current income, the company was on a sound basis?

A. Any assessable company never can become insolvent. *The* haven't the right of assessment.

Mr. Aarons: May it be understood, if the court please, that I retain and continue my objection to the classification of the company as an assessment company.

Q. (By Mr. Aarons): Under the procedure under which the company now operates as a legal reserve company, Mr. Reese, each individual company was evaluated and a policy reserve placed against that individual policy?

(Testimony of M. C. Reese.)

A. Under all business written since March, 1947, legal reserve business requires not forfeiture values by law, and consequently they are figured upon an interest increment rate, in order to provide the loan values and the reserve values, which the person can withdraw at any time, the policy holder.

Q. The legal reserve is calculated by evaluating each particular policy, is it not?

A. With the exception of what we would call term insurance or group insurance. That is termed legal reserve insurance, but there is no value to it, other than just the straight death benefit.

Q. Then, is the main difference between legal reserve and the way you formerly operated, namely, that the reserve, policy reserve, for each policy must build itself up with interest increases?

A. Yes.

Mr. Aarons: If the court please, that is all I have to ask, excepting that I wish to ask the court's permission for substitution of photostatic copies of the returns placed in evidence.

The Court: That may be done.

Mr. Weaver: If the court please, I would like to ask a question or two in regard to matters taken up by counsel.

The Court: Proceed.

Redirect Examination

By Mr. Weaver:

Q. Mr. Reese, isn't it a fact that the difference between the reserve of a legal reserve company and

(Testimony of M. C. Reese.)

an ordinary benefit society is that the legal reserve is a reserve against each policy, while that of the benefit society is a common reserve against all of its liability? A. Yes.

Q. The legal reserve, that has nothing to do with bank accounts? A. No.

Q. It is a difference in bookkeeping system?

A. A difference in the bookkeeping system.

Q. The testimony of Mr. Betts—you were asked your recollection of that testimony. Isn't it your recollection that he had testified that the Corporation Commission submitted these policies to an actuary and received an assurance that it was equivalent to the American experience table of 3 per cent, before they approved it?

A. It is my recollection of the testimony that he stated that the rates were sufficient to meet the current mortality losses, in accordance with American experience mortality table, which would mean on a straight term to term basis.

Q. Now, in regard to the question that was asked you in regard to the meeting of these claims as they were presented, did you at any time during the early life of the company transfer funds from the expense account to the mortuary?

A. Yes, sir.

Q. That was done, a \$3000 item in the year of 1939? A. Yes, sir.

Q. In other words, expense money was transferred to the mortuary to meet the claims?

(Testimony of M. C. Reese.)

A. Yes.

Q. None of your assets were—in the way of bank accounts or any other assets—none were earmarked for any particular reserve, but were on the opposite side of the ledger from all liability?

A. They were marked plainly for those to go into the claim fund, and those to go into the expense fund.

Q. That is, the funds as they come in, your funds are so separated? A. Yes.

Mr. Weaver: I believe that is all.

The Court: Have you any other questions?

Mr. Aarons: Just one question, if the court please.

The Court: Proceed.

Recross-Examination

By Mr. Aarons:

Q. Mr. Reese, would you identify this volume as being the U. S. Circuit Court of Appeals for the Ninth Circuit, a transcript of record in the case of First National Benefit Society vs. W. P. Stewart, transcript No. 11039?

A. I know this looks like it. I would say this is it. I have read part of it.

Mr. Aarons: If the court please, since there have been several references in the testimony to the previous case, the 1938 case, I think it may be helpful to the court to have the transcript of the record in this case, and I so offer it.

(Testimony of M. C. Reese.)

Mr. Weaver: If the court please, I object to it for the reason that it makes such a tremendous record. This company has already had involved, and in some years coming up, will have over \$53,000 in taxes in question, and if we should want to take this case up at any time, it would make a tremendous record to have that involved in it, and I don't believe it is necessary.

The Court: What do you propose to prove by that? How do you operate?

Mr. Aarons: Well, there were several references in the testimony, your Honor, to the testimony of Amos Betts.

The Court: Are you proposing that the testimony appearing in that record be incorporated as a part of the transcript here?

Mr. Aarons: No, your Honor, but to verify whether or not the statements made as to the testimony in that case are statements now made, correct statements.

The Court: I will sustain the objection. Is there anything further?

Mr. Aarons: No, sir.

Mr. Weaver: Not with this witness, if the court please. I have one more witness for just a moment.

(Witness excused.)

I will call Mr. Harber.

Whereupon,

D. A. HARBER

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name, please.

The Witness: D. A. Harber.

Direct Examination

By Mr. Weaver:

Q. What is your profession, Mr. Harber?

A. I am an accountant.

Q. You were at one time an accountant for the insurance department of Arizona?

A. An examiner.

Q. You are now an accountant—what is your present occupation?

A. An accountant and auditor for the First National Life Insurance Company.

Q. How long have you been in that business?

A. Since September, 1947.

Q. Are you familiar with the books of the corporation? A. Yes, I have reviewed them.

Q. And the books of the First National Benefit Society in the same office?

A. I have reviewed them in regard to this case.

Q. These books are quite voluminous?

A. Quite so, yes, sir.

Q. But you have examined these books and made certain transcripts from them? A. Yes, sir.

(Testimony of D. A. Harber.)

Q. I am showing you a statement, what purports to be a statement, showing the increase and decrease in the mortuary funds and expense fund of 1939. Was this prepared by you from the books?

A. Yes, sir, and adjusted by the—our books are on a cash basis, and this statement was made from the books and adjusted by the accrued losses at the beginning of the year, the end of the year, and also by adjusting the depreciation for furniture and equipment to the amount allowed by the Commissioner, and adding back a Federal income tax paid item that was included in the deduction from the expense fund.

Q. That was the original error——

A. No, our ledger would show that as an expense, while it would not be an expense allowance for income tax purposes.

Q. This was actually prepared by you from these books? A. Yes, sir.

Mr. Weaver: I am offering this statement in evidence.

The Witness: There is another adjustment. The books show there is a \$3000 transfer from the expense fund to the mortuary fund, and the books showed it divided between the mortuary fund and the morbidity fund. The State Examiner threw it all into the mortuary fund, and this statement agrees with the Examiner's report for that year.

The Court: Is there objection?

Mr. Aaron: I would like to ask the witness a

(Testimony of D. A. Harber.)

question before I state whether I object or not, if the court please.

The Court: Proceed.

Cross-Examination

By Mr. Aarons:

Q. Mr. Harber, have you testified as to any and all differences or discrepancies that there might be between the figures shown on this sheet and the figures as they are shown on your corporate books and records?

A. As far as my knowledge, it is reconciled from the banking examiner's report—the insurance examiner's report, which was made from the records of the company.

Q. And you believe that this sheet does show a true financial picture of the status of these two funds specified thereto?

A. It shows the proper income and disbursements to the two separate funds as kept by the company.

The Court: Any further questions?

Mr. Aarons: I don't have anything further, your Honor.

The Court: Exhibit 3.

The Clerk: 3 through 9 are attached to the stipulation.

The Court: Is this a joint exhibit?

Mr. Weaver: This is not a joint exhibit.

(Testimony of D. A. Harber.)

Mr. Aarons: This will be Exhibit No. 10, if the court please.

The Court: Exhibit No. 10.

(The document above-referred to was received in evidence and marked Petitioner's Exhibit No. 10.)

Mr. Weaver: That is all.

Mr. Aarons: I have nothing further.

Mr. Weaver: If the court please, that is our case. We rest.

Mr. Aarons: Respondent rests.

The Court: The clerk will fix the time for filing of briefs, in accordance with the rule.

The Clerk: January 14, 1949, for the opening briefs, and January 31, 1949, for the reply brief.

The Court: I believe that is all we have today. We will recess until 2:00 o'clock tomorrow.

(Whereupon, at 3:20 o'clock p.m., Tuesday, November 30, 1948, the hearing in the above-entitled matter was closed.)

[Endorsed]: Filed Dec. 21, 1948.

[Title of Tax Court and Cause.]

STIPULATION

It is hereby stipulated and agreed, by and between the parties hereto, through their respective counsel, that the following facts shall be taken as true, and that the following described exhibits may be received in evidence, without prejudice to the right of either party to introduce other and further evidence not inconsistent herewith:

1. Petitioner is a corporation organized and existing under and by virtue of the laws of the State of Arizona. Petitioner filed its Federal income tax return for the calendar year 1939 with the Collector of Internal Revenue for the District of Arizona. On its said return petitioner reported no tax liability. The tax in controversy is income tax for the calendar year 1939, in the amount of \$1,135.83, which represents the deficiency determined by respondent.

2. During the period involved, petitioner was engaged in business under the "Benefit Corporation Law of 1937" of the State of Arizona, being Chapter 36 of the Arizona Session Laws of 1937, and incorporated in the Arizona Code of 1939 as sections 53-601 to 53-622 inclusive.

3. Attached hereto as Joint Ex. 1-A are the Articles of Incorporation and By-Laws of petitioner as the same existed during the year 1939, including the amendments to the said By-Laws as they then existed.

4. Attached hereto as Joint Ex. 2-B are blank printed forms H, XXX, XXX-GG, XXX-J, XXX-FG, and AH-1, being forms of membership certificates and insurance policies typical of those issued by petitioner during the year 1939.

5. The type and number of policies issued by petitioner and in force as of May 31, 1939, were as follows:

Type	Number of Policies
Assessment Forms	34
Individual	7,253
Family group	2,369
Joint	685
Juvenile	219
Health and Accident.....	249
Penny a Day.....	181
Total	<u>10,990</u>

6. Petitioner's income during the calendar year 1939 was entirely from premium payments and none of its income was from interest, dividends or rents.

7. Attached hereto as Petitioner's Ex. 3 is a transcript of petitioner's general ledger accounts for the year 1939.

8. Attached hereto as Petitioner's Ex. 4 are photostatic copies of the final monthly sheets of petitioner's Receipts Journal for the year 1939 with recapitulation of amounts transferred to other accounts of the general ledger.

9. Attached hereto as Petitioner's Ex. 5 are photostatic copies of the final monthly sheets of petitioner's Disbursements Journal for the year 1939.

10. Attached hereto as Petitioner's Ex. 6 is a photostatic copy of the sheet of petitioner's Disbursements Journal for the year 1939 showing closing entries for such year.

11. Attached hereto as Petitioner's Ex. 7 are photostatic copies of petitioner's journal for the year 1939.

12. Attached hereto as Petitioner's Ex. 8 is a copy of petitioner's minutes adopting Salary Contract of June 30, 1937, with M. C. Reese, petitioner's president.

13. Attached hereto as Petitioner's Ex. 9 is a schedule of petitioner's Salary Contract Liability to M. C. Reese, petitioner's president.

/s/ ROBERT R. WEAVER,
Counsel for Petitioner.

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of
Internal Revenue,
Counsel for Respondent.
E.C.C.

[Endorsed]: Filed Nov. 30, 1948. T.C.U.S.

The Tax Court of the United States

Docket No. 14661

FIRST NATIONAL BENEFIT SOCIETY,
a Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

1. Petitioner failed to establish that it was a life insurance company as contemplated by section 201, I.R.C., and entitled to be taxed as such, its so-called "reserve funds" not being held exclusively for the fulfillment of its life insurance and other like contracts and being subject to invasion for other purposes.

2. Petitioner as a mutual insurance company, other than life, is not entitled to a deduction for a deposit made with the State Treasurer of Arizona since the reserve funds were not such as those specified in section 201(c)(1)(A).

3. During the taxable year, petitioner was not an assessment company and as such not entitled to deductions claimed under section 207(c)(1)(A).

4. Petitioner, on a cash basis, is not entitled to a deduction for a portion of its general manager's compensation not paid in 1939 but claimed as an accrued expense liability.

Robert R. Weaver, Esq., for the petitioner.

L. C. Aarons, Esq., for the respondent.

MEMORANDUM FINDINGS OF FACT
AND OPINION

The respondent determined a deficiency of \$1,135.83 in the petitioner's income tax liability for the year 1939.

The primary issue is whether the petitioner, during the year 1939, was a life insurance company within the provisions of section 201 of the Internal Revenue Code, or was a mutual insurance company, other than life, within the meaning of section 207 thereof.

If the petitioner is held to be a mutual insurance company other than life, as defined by section 207, the subordinate issues are:

1. Was the petitioner entitled to a deduction of \$4,518.71, deposited with the Arizona State Treasurer during the taxable year, under the provisions of section 207(c)(1)(A)?

2. Was the petitioner, on the cash basis, entitled to deduct \$3,675.41 representing the unpaid portion of the salary of its president due during the taxable year?

3. Was the petitioner entitled to deduct further amounts under the provisions of section 207(c)(3)?

Findings of Fact

Certain facts were stipulated. The portions thereof material to the issues are as follows:

The petitioner is a corporation organized and existing under and by virtue of the laws of the State of Arizona. The petitioner filed its Federal income tax return for the calendar year 1939 with the collector of internal revenue for the district of Arizona. On its return the petitioner reported no tax liability.

During the period involved, the petitioner was engaged in business under the "Benefit Corporation Law of 1937" of the State of Arizona, being Chapter 36 of the Arizona Session Laws of 1937, and incorporated in the Arizona Code of 1939 as sections 53-601 to 53-622, inclusive. Its purpose was——

That the objects and purposes for which said Corporation is formed are: To engage in, conduct and carry on the business and customary activities of a mutual benefit association within the meaning and provisions of Sections 607-608-609-610 of Chapter 14 of Article 3 of the 1928 Revised Statutes of the State of Arizona as the same now exists; * * *

In the Articles of Incorporation, the petitioner is given authority to issue certificates of membership in assessment form and guaranteed cost certificates of various types. Its contractual liabilities "upon any one member" was specifically limited in both cases. Its funds were denominated (1) Benefit Fund, (2) General Fund, and (3) Reserve Fund and/or Trust Fund. The funds were described as follows:

Benefit Fund and/or Reserve Fund and/or Trust Fund: The Benefit Fund and/or Reserve Fund

and/or Trust Fund of the Corporation, consisting of those moneys received shall be used for the purpose of payment of claims originating under and in connection with claims pertaining to all certificate forms, and in addition thereto such funds shall be charged a nominal amount for each claim in connection therewith as expense money as so allocated by all contracts of membership. Such amount to be determined from time to time as the Board of Directors may deem advisable.

General Fund: The General Fund consisting of the membership fee, semiannual dues, and other portions of money so allocated to said fund from any source whatsoever, and shall be used for general administration purposes of the business in its entirety except payments of death claims, and the General Fund of the Corporation shall in no way be subject for use of payment of any death claims unless at the discretion of the Board of Directors.

Reserve Fund and/or Trust Fund: The Reserve Fund shall be distributed to the Benefit Fund and consist of those moneys allocated to such fund as so specified in the Guaranteed Cost certificates of membership, and such fund shall be used for payment of death claims as so specified membership certificates; and in addition thereto such funds shall be charged a nominal amount for each claim in connection therewith, as expense money as so allowed by all contract of membership. Such amount to be determined from time to time as the Board of Directors may deem advisable.

The scope of the petitioner's funds was set forth as follows:

Section I. The funds of the Society which consist of the following: The Benefit Fund and/or Reserve Fund and/or Trust Fund, and such other funds as the Board of Directors may hereafter from time to time determine and establish. A separate accounting for such funds shall be kept in the books of the Society.

Section II. Benefit Fund, and/or Reserve Fund, and/or Trust Fund: The Benefit Fund, and/or Reserve Fund, and/or Trust Fund, which consist of all moneys paid to or coming into the possession of the Society, during the notice period allowed in the certificate and notice for the payment of death assessments made from time to time by order of or direction of the Board of Directors for the purpose of paying death claims of members, taxes and other necessary expenses incurred in the administration and defense of said fund.

Section III. General Fund: The General Fund which shall consist of such amounts so specified as dues and other renewal moneys collected after the notice period allowed in the certificate and notice for the payment of the death assessments shall be used to defray expenses incidental to the operation of the Society, including salaries, rentals, printing, postage, etc.

Section IV. Reserve Fund and/or Trust Fund:

The Reserve Fund and/or Trust Fund, shall consist of those moneys allocated to such fund as so specified in certificate of membership so issued by the Corporation. Such moneys shall be used for payment of death claims in accordance with the terms of the membership certificates and for taxes and other necessary expenses incurred in the administration and defense of said fund.

By amendments to its By-Laws the petitioner was authorized to issue various certificates called Guaranteed Reserve, Juvenile, Family Burial, Family Group, Accident and Health, Joint policy, "Penny a day life," Death Benefit, etc., and various modifications of the certificates already authorized.

The petitioner issued Forms H, XXX, XXX-GG, XXX-J, XXX-FG, and A-H-1 typical of membership certificates and insurance policies issued by it during 1939. All of these policies were designated "Guaranteed Reserve Certificates." In all of them appears the provision, "The member shall not be liable for any debts of the Corporation or for any other obligations save and except the premium deposits required hereon and then only so long as the Certificate remains in force and effect." Form H covered death from any cause; Form XXX covered natural and accidental death and loss of limb; Form XXX-GG covered natural death of member and accidental death of member and beneficiary; Form XXX-J covered natural and accidental death of member and co-member; Form XXX-FG covered natural and accidental death of the member and

dependents, while Form A-H-1 covered accidental loss of life and limb, disability benefits, etc. Each policy provided that premium deposits after one year from the date of the policy should consist of the certificate fee and General Fund Dues and after the payment of the General Fund Dues the remainder of such deposits should "be placed in a Trust Fund for distribution to the Mortuary Fund as required"; except Form A-H-1 which required the remainder to be distributed to the "claim fund."

All policies contained the clause:

Reserve: The By-Laws of the Corporation require the deposit in an amount not less than fifty per cent (50) of each premium deposit for the purpose of payment of claims and expenses incidental thereto.

The type and number of policies issued by the petitioner and in force, as of May 31, 1939, were as follows:

Type	Number of Policies
Assessment Form	34
Individual	7,253
Family group	2,369
Joint	685
Juvenile	219
Health and Accident	249
Penny a Day	181
<hr/>	
Total	10,990

The petitioner's income during the calendar year 1939 was entirely from premium payments and none of its income was from interest, dividends or rents.

On June 30, 1937, the petitioner's board of directors, consisting of M. C. Reese, M. S. Reese and C. W. Reese, authorized the petitioner to employ M. C. Reese as its general manager for a term of 20 years and pay him for his services a sum equal to 10 per cent of the petitioner's gross income. During the year 1939 Reese earned \$18,075.11 pursuant to the employment contract but was paid only \$12,000, leaving a sum of \$6,075.11 on its books as due to him.

The record discloses the following additional facts:

The petitioner maintained only one bank account in which all its receipts were placed. No attempt was made by the petitioner to separate the various expense and reserve funds. The actual segregation was shown only on its books. Its books were maintained on a cash basis and its income tax return was filed on that basis.

Prior to and during the taxable year the petitioner relied on its annual premium receipts to pay its current expenditures, including claims. Prior to March, 1947, when the petitioner became a legal reserve company, no valuation was made of individual policies as a basis of determining the proper legal reserve. As the petitioner now operates, the policy reserves must build themselves up with interest increases.

In all its years of operation the petitioner never levied any assessments against its members or policy holders.

In showing the financial status of the petitioner's "Mortuary Fund" during 1939, losses or claims were accrued at the beginning and end of the year. The petitioner's books and records in other respects conform to the cash basis of accounting. Upon examining the petitioner's income tax return for the year 1939, showing no tax liability, the Commissioner held that its contention that it should be classified as a life insurance company under the provisions of section 201, I.R.C., was denied and that it was a mutual insurance company under section 207 thereof. He then determined an adjusted net income of \$6,883.83 as disclosed by the petitioner's books. The adjustments were made with the following explanations:

Items deducted in computing net income shown in your audit report not deductible for income tax purposes:

(a)	Compensation under M. C. Reese	
	Contract	\$3,675.41
(b)	Amount deposited with State Treasurer	4,518.71
(c)	Accrued losses (Claims) December 31, 1939	47.34
		<hr/>
		\$8,241.46

(d) Less: Accrued losses (Claims) December 31, 1938 overstated in your audit report 3,323.00

Difference as shown above \$4,918.46

(a) Compensation under M. C. Reese Contract—
\$3,675.41

The amount claimed as a deduction in your audit report as compensation due M. C. Reese under an alleged employment contract amounts to \$18,075.41. The amount actually paid Mr. Reese during the year under said alleged contract amounted to \$14,400.00; the difference, \$3,675.41, is disallowed for the reason that your books and records are on the cash basis of accounting.

(b) . Amount deposited with State Treasurer—
\$4,518.71

The amount, \$4,518.71, deposited with the Arizona State Treasurer during the taxable year does not constitute additions required by law to be made within the taxable year to reserve funds within the meaning of section 207 of the Internal Revenue Code and therefore is not a proper deduction in computing your taxable net income under that section of the Act.

(c) Accrued losses (claims) at December 31, 1939—\$47.34

The amount of accrued losses (claims) at December 31, 1939 shown in your audit report at \$4,299.99

has been reduced to \$4,252.65. The balance, \$47.34, has not been substantiated as proven claims.

(d) Accrued losses (claims) at December 31, 1938—\$3,323.00

The amount of accrued losses (claims) at the beginning of the taxable year 1939, shown in your audit report at \$5,155.49, has been reduced to \$1,832.49, the amount reflected in the computation of your taxable net income for the preceding taxable year 1938 as accrued losses (claims) at the close of that year.

Opinion

Van Fossan, Judge:

The basic question at issue is whether or not the petitioner is a life insurance company as contemplated by the provisions of section 201, I.R.C., and, under the facts of record, free from tax liability, or was a mutual insurance company other than life and entitled to certain deductions as such, as provided in section 207.

The respondent's contention is that the petitioner is not a true life insurance company because it did not have "reserve funds" and that the "reserves," if any, were not "held for the fulfillment of its insurance contracts." He invokes section 19.203 (a)(2)-1 of Regulations 103¹ which contains the

¹Sec. 19.203(a)(2)-1. Reserve Funds — In general, the reserve contemplated is a sum of money, variously computed or estimated, which, with accretions from interest, is set aside (reserved) as a fund

definition of the word “reserve,” adapted, as the respondent says, from the definition of that word as found in *Maryland Casualty Co., v. United States*, 251 U.S. 342.²

It was stipulated that the petitioner’s income was derived wholly from premium payments and that none of it came from interest, dividends, or rents. Section 202(a)(1) defines the gross income of life insurance companies as follows:

Sec. 202. Gross Income of Life Insurance Companies.

(a) Gross Income Defined—

(1) In General—In the case of a life insurance company the term “gross income” means the gross amount of income received during the taxable year from interest, dividends, and rents.

The petitioner argues, therefore, that since it had no income from interest, dividends and rents it had no tax liability. It assumes and contends that it

with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims.

²The term “reserve” or “reserves” has a special meaning in the law of insurance. While its scope varies under different laws, in general it means a sum of money, variously computed or estimated, which, with accretions from interest, is set aside—“reserved”—as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims, and claims accrued, but contingent and indefinite as to amount or time of payment.

was a true life insurance company and qualified as such under the statutory definition of that type of organization as set forth in section 201(a), as follows:

Sec. 201. Tax On Life Insurance Companies.

(a) Definition—When used in this chapter the term “life insurance company” means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

A brief history of life insurance company taxation as it relates to section 201 is found in *Helvering v. Oregon Mutual Life Ins. Co.*, 311 U.S. 267, as follows:

Legislative history discloses that a deduction similar to that allowed by section 203(a)(2) first appeared in the Revenue Act of 1921, and has reappeared in every revenue measure since, including that of 1939. Prior to 1921, insurance companies had not been allowed such a deduction, but had been subject to the same tax plan as corporations generally; the 1921 Act, however, wholly exempted insurance companies from the general scheme of corporate taxation and set up special systems applicable to them alone. The new plan, as it related to life insurance companies, had as a major objec-

tive the elimination of premium receipts from the field of taxable income. It had long been pointed out to Congress that these receipts, except as to a very minor proportion of each premium, were not true income but were analogous to permanent capital investment. In all the Revenue Acts from 1921 through 1939, the gross income of life insurance companies no longer included premium receipts, but was limited to income "from interest, dividends, and rents." And, pursuant to the conceived analogy of reserves to capital investment, net income was to be determined by permitting, among other deductions from gross income, that same deduction here in dispute—a percentage of the "reserve funds required by law."

As entirely new and separate tax provisions relating only to life insurance companies were thus enacted, it became necessary specifically to define what constituted a "life insurance company" within the meaning of the Act. Therefore, it was declared in the 1921 Act and all its successors that "when used in this title [chapter] the term 'life insurance company' means an insurance company engaged in the business of issuing life insurance, and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds."

In the case at bar the controversy on this point

is narrowed down to the factual issue whether or not more than 50 per cent of the petitioner's reserve funds were held for the fulfillment of its life, health, disability and other contracts which came within the purview of the statute. Upon careful study of the record we find no adequate support of the petitioner's theory. In fact, the weight of the evidence is strongly against him.

The petitioner maintained only one bank account into which the receipts from all sources were deposited and from which all disbursements were made. No segregation or allocation was made of the receipts, except a nominal one, on the petitioner's books. The petitioner made no attempt to separate its various expense and reserve funds. It relied on its current premium receipts to pay its current expenditures including claims. No evaluation was made of individual policies from which a correct legal reserve might have been established. The petitioner never levied any assessments against its members or policy holders. In fact, with an insignificant exception, (34 out of 10,900) "assessment forms" were not issued. In all but one of the certificates submitted to us a clause was inserted that the petitioner's by-laws required a deposit not less than 50 per cent (no more) of the premiums for the payment of "claims and expenses incidental thereto." Even the exhibits submitted by the petitioner purporting to show the flow of funds into the mortuary reserve do not help its position.

The petitioner's Articles of Incorporation did not

require that any reserve should be held exclusively for the purpose of paying claims arising out of the "certificate" contracts but the so-called reserve funds might be invaded for any purpose. In *Commissioner v. National Reserve Ins. Co.*, 160 Fed. (2d) 956, the taxpayer, an Arizona corporation, was organized pursuant to the provisions of the Arizona "Benefit Corporation Law," the same legislation under which the petitioner was organized. In that case the Court held that although the reserve for the fulfillment of policy claims amounted to more than 50 per cent of the total reserve fund, the corporation was not a life insurance company because the reserve was also held for additional purposes. The Court further held that "Since the Company maintained only one 'reserve' fund, its mortuary fund, and since this fund was subject to invasion for premium refunds, it does not meet the statutory test which specifies a reserve fund held only to fulfill contracts." Thus the decision of the Circuit Court of Appeals sustains the respondent's contention that the reserve must be set aside exclusively for the fulfillment of contracts classified as life insurance commitments.

As a side light to the conclusion of the Court in the *National Reserve* case we note that in the report of the Committee on Ways and Means accompanying H.R. 7378, relating to the Revenue Bill of 1942, 77th Congress, 1st Session, the statement is made:

Section 201(c)(2) is new and defines the term "life insurance reserves." The definition is substan-

tially that contained for many years in the regulations with the addition that the reserves must be based on recognized mortality or morbidity tables, the health and accident reserves must be noncancelable, and unpaid loss reserves on such health and accident contracts are included if computed on a discount basis.

We also note that the petitioner was organized and engaged in business by authority of the Benefit Corporation Law of 1937 of Arizona (Chapter 36 Arizona Session Laws of 1937—Sections 53-601 to 53-622, inclusive, Arizona Code of 1939) and not under Chapter 61, Arizona Code of 1939, which covers the creation, operation and regulation of life insurance companies. This fact is significant in evaluating the petitioner's attempt to secure the benefit of Federal tax exemption. Further in its Articles of Incorporation it states precisely that it was formed to "engage in, conduct and carry on the business and customary activities of a mutual benefit association within the meaning and provisions of Section 607 (et seq.)."

Section 53-605 (one of the provisions in the Arizona Code corresponding to Section 607 et seq.) provides that a benefit corporation shall deposit with the state treasurer of Arizona \$1,000 before receiving its certificate, \$1,000 in monthly payments and shall make further deposits of \$1 for each \$1,000 of protection until a total of \$10,000 shall have been so deposited. The deposits so made are subject to a lien for any unsettled final judgment of a court of

Arizona (Section 53-605(d)) and any interest earned on the deposit or other corporate assets may be used for general operating expenses (Section 53-605(c) and 53-609(b)). It is obvious that the petitioner's so-called "reserve" held by the state treasurer of Arizona is not that contemplated by the statute since it may be invaded and completely wiped out at any time for purposes other than fulfilling its contractual obligations referred to in section 201(a), *I.R.C. First National Benefit Society, v. Stuart*, 134 Fed. (2d) 438.

In *Helvering v. Inter-Mountain Life Ins. Company*, 294 U.S. 686, the Court said:

The word "reserve" has many meanings. Accounts creating reserves are set up in almost every line of business and funds evidenced by the book entries are held for many and widely different purposes. As the act does not permit corporations other than insurance companies to make deductions of the kind here under consideration, "reserve funds" may not reasonably be deemed to include values that do not directly pertain to insurance. In life insurance the reserve means the amount, accumulated by the company out of premium payments, which is attributable to and represents the value of the life insurance elements of the policy contracts.

In that the petitioner's reserve bore no relationship to life insurance values it has also failed to con-

form its reserve to the concept of an insurance reserve as contemplated by the statute.

Therefore, we sustain the respondent's determination that the petitioner, during the taxable year 1939, was not a life insurance company as defined in section 201.

The respondent has taxed the petitioner as a mutual insurance company, other than life, pursuant to the provisions of section 207. Under section 207(c)³ such a company is entitled to certain deductions. The petitioner claims that the sum of \$4,518.71 deposited with the State Treasurer of Arizona during the taxable year was deductible as a net addition required by law to be made to its reserve funds. The respondent contends that such deposits were not those "required by law." What

³Sec. 207. Mutual Insurance Companies Other Than Life.

* * *

(c) Deductions—In addition to the deductions allowed to corporations by section 23 of the following deductions to insurance companies shall also be allowed, unless otherwise allowed—

(1) Mutual Insurance Companies Other Than Life Insurance—In the case of mutual insurance companies other than life insurance companies—

(A) the net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds); and

(B) the sums other than dividends paid within the taxable year on policy and annuity contracts.

we have said concerning the nature of the petitioner's so-called "reserve" funds in our discussion of the primary issue is equally applicable to this collateral issue.

Section 19.207-4 of Regulations 103 defines "reserve funds required by law" as follows:

* * * Reserve funds "required by law include not only reserves required by express statutory provisions but also reserves required by the rules and regulations of State insurance departments when promulgated in the exercise of an appropriate power conferred by statute, but do not include assets required to be held for the ordinary running expenses of the business, such as taxes, salaries, re-insurance, and unpaid brokerage. Only reserves commonly recognized as reserve funds in insurance accounting are to be taken into consideration in computing the net addition to reserve funds required by law.

In *Commissioner v. National Reserve Insurance Co.*, supra, the Court held that funds so deposited with the Arizona treasurer do not comply with the requirements of Section 19.203(a)(2)-1. In other words, it is not a real reserve fund. Since the "net addition" required by the Arizona statute was not made to a "reserve" fund, the deduction is not allowable.

The petitioner argues further that it was an assessment company during the taxable year and thus comes within the parenthetical inclusion of section

207(c)(1)(A). Assuming that the petitioner maintained such a reserve fund—and we have held otherwise—it has not proven that it was an assessment company.

During 1939 it had in force only 34 out of 10,900 outstanding “policies” (or a .32+ per cent), labeled “Assessment Forms,” the remaining being clearly not subject to assessment, as shown by the facts that the payments are called premiums, the contracts are called certificates or policies and their holders are denominated members or policy holders. Such “assessment forms” were not presented in evidence. We cannot determine their true character from their name alone. Consequently, the petitioner has failed to show that it was an assessment company and functioned as such during the taxable year. We, therefore, reject this contention.

In the second subordinate issue the petitioner claims the right to deduct \$3,675.41 representing the accrued portion of the compensation of its general manager (who is also its president) unpaid in 1939. It argues that since the respondent accrued the petitioner’s unpaid claims, which were reported at the close of the year and upon which no proof of claim had been made, he should have accrued also the unpaid portion of its president’s compensation or “salary.”

The petitioner made its return on the cash basis. The respondent accepted that basis and so computed all other items thereon with the single exception of the unpaid claims. He deemed that such treatment

was necessary correctly to reflect the petitioner's true income and the petitioner has not challenged the propriety of his action. Reese's salary or compensation is in the same category as other expense items and should be treated similarly—on the cash basis.

The petitioner has failed to present any evidence proving his claim to certain other deductions under section 207(c)(3) and, therefore, is considered to have abandoned the issue relating to them.

Decision will be entered for the respondent.

Received Sept. 1, 1949.

Entered Sept. 13, 1949.

The Tax Court of the United States, Washington
Docket No. 14661

FIRST NATIONAL BENEFIT SOCIETY,
a Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Memorandum Findings of Fact and Opinion, entered September 13, 1949, it is

Ordered and Decided: That there is a deficiency in income tax of \$1,135.83 for the year 1939.

[Seal] /s/ ERNEST H. VAN FOSSAN,
Judge.

Entered September 13, 1949.

Served September 14, 1949.

[Title of REDACTED Court and Cause.]

FILE MEMORANDUM IN RE: BOND

Amount of bond \$2271.66, Surety First Nat'l Benefit Society.

Date Approved & Filed Nov. 29, 1949. Approved by Judge Van Fossan.

ROBERT R. WEAVER,
Counsel for Petitioner,
403 First National Bank
Bldg., Phoenix, Arizona.

[Title of Tax Court and Cause.]

PETITION FOR REVIEW

The First National Benefit Society, hereinafter referred to as Petitioner, hereby petitions the United States Court of Appeals for the Ninth Circuit to review the decision entered by the Tax Court of the United States on September 13, 1949, ordering and deciding that there is a deficiency in income

tax due from Petitioner on review, for the calendar year 1939.

This Petition for review is filed pursuant to the provisions of Section 1141 and 1142 of the Internal Revenue Code.

The First National Benefit Society, Petitioner on review herein was incorporated on March, 1934, under Sections 607-610 of the 1928 Revenue Statutes of Arizona. During the period involved, the Petitioner was engaged in business under the "Benefit Corporation Law of 1937" of the State of Arizona, being Chapter 36 of the Arizona Session Laws of 1937, and incorporated in the Arizona Code of 1939 as sections 53-601 to 53-622, inclusive.

Said company filed its tax return for the year 1939 showing no income tax due with the Collector of Internal Revenue for the District of Arizona at Phoenix, Arizona, whose office is within the jurisdiction of the United States Court of Appeals for the Ninth Circuit, wherein this review is sought.

Nature of Controversy

The nature of the controversy is as follows:

The primary issue is whether the petitioner, during the year 1939, was a life insurance company within the provisions of section 201 of the Internal Revenue Code, or was a mutual insurance company, other than life, within the meaning of section 207 thereof.

If the petitioner is held to be a mutual insurance company other than life, as defined by section 207, the subordinate issues are:

1. Was the petitioner entitled to a deduction of \$4,518.71, deposited with the Arizona State Treasurer during the taxable year, under the provisions of section 207(c)(1)(A)?

2. Was the petitioner entitled to deduct \$3,675.41 representing the unpaid portion of the salary of its president due during the taxable year?

3. Was the petitioner entitled to deduct further amounts under the provisions of section 207(c)(3)?

Petitioner had been during the year 1939 and prior thereto writing insurance under the Mutual Benefit Law of the State of Arizona above referred to and its policies with the exception of a negligible amount where life insurance policies and its losses contingent upon death. Its reserve funds were held under the provisions of the Mutual Benefit Law of 1937, which were incorporated in the 1939 Arizona Code as Sections 53-601 to 53-622, inclusive.

Under this law the Petitioner must set aside a definite portion of its premium income in a Mortuary Fund. Petitioner is also required under said law to maintain a deposit with the State Treasurer of \$10,000.00. If Petitioner is a life insurance company under the provisions of section 201 of the Internal Revenue Code as it existed in 1939, under section 202 it would be taxed on its investment income, if it is not a life insurance company, but is a mutual insurance company other than life, under section 207 as the Respondent has classified Petitioner it would be entitled to the deductions under the subsections set out above for moneys held for

the payment of losses and expenses and those held as required by law in the form of a deposit with the State Treasurer.

There is also involved the question as to whether or not Petitioner is an assessment company within the meaning of the Internal Revenue Code providing for the taxation of assessment life insurance companies.

All of these issues were decided against Petitioner in the decision of the United States Tax Court entered herein on September 13, 1949.

Dated this 10th day of November, 1949.

/s/ ROBERT R. WEAVER,
Attorney for Petitioner.

Affidavit of service by mail attached.

Received Nov. 14, 1949, T.C.U.S.

Filed Nov. 29, 1949, T.C.U.S.

[Title of REDACTED Court and Cause.]

NOTICE OF FILING PETITION
FOR REVIEW

To: Honorable Charles Oliphant, Chief Counsel,
Bureau of Internal Revenue, Washington,
D. C., and L. C. Aarons, Bureau of Internal
Revenue, 1100 Oviatt Building, Los Angeles,
California

You are hereby notified that the Petitioner, First
National Benefit Society, did on the 29th day of

November, 1949, file with the Clerk of the Tax Court of the United States, at Washington, D. C., a Petition for Review by the United States Court of Appeals for the Ninth Circuit of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 29th day of November, 1949.

/s/ ROBERT R. WEAVER,
Attorney for Petitioner.

Receipt of copy acknowledged.

Received Nov. 14, 1949, T.C.U.S.

Filed Nov. 29, 1949, T.C.U.S.

[Title of Tax Court and Cause.]

AFFIDAVIT OF SERVICE BY MAIL

State of Arizona,
County of Maricopa—ss.

Robert R. Weaver, being first duly sworn deposes and says: That affiant is a citizen of the United States and a resident of the County of Maricopa, that affiant is over the age of eighteen years, an Attorney at Law, and attorney of record in the above-entitled and foregoing action before the Tax Court of the United States, that affiant's business address is 403-04 First National Bank Bldg., Phoenix, Arizona; that on the 25th day of Novem-

ber, 1949, affiant served the within Designation of portion of the record to be certified, titled in the Tax Court of the United States and Request for preparation for the certification of the record, on the Respondent in said action, by placing a true copy of said Designation and Request in an envelope with postage prepaid addressed to:

Honorable Charles Oliphant, Chief Counsel,
Bureau of Internal Revenue, Washington, D. C.

L. C. Aarons, Bureau of Internal Revenue, 1100
Oviatt Building, Los Angeles, California,
and then by sealing said stamped envelope and depositing the same in the United States mail at Phoenix, Arizona, where is located the office of the attorney for Petitioner herein; that there is a regular communication by mail between the place of mailing and the place so addressed.

/s/ ROBERT R. WEAVER.

Subscribed and sworn to before me this 25th day
of November, 1949.

[Seal] /s/ ROBERT C. MOORE,
Notary Public in and for the County of Maricopa,
Arizona.

My Commission Expires Sept. 29, 1951.

Received Nov. 28, 1949, T.C.U.S.

Filed Nov. 29, 1949, T.C.U.S.

[Title of Tax Court and Cause.]

REQUEST FOR PREPARATION FOR THE
CERTIFICATION OF THE RECORD

The Petitioner hereby requests the Clerk of the above-entitled Court to prepare and certify the record for review in the above-entitled matter.

Dated this 23rd day of November, 1949.

/s/ ROBERT R. WEAVER,
Attorney for Petitioner.

Received Nov. 28, 1949, T.C.U.S.

Filed Nov. 29, 1949, T.C.U.S.

[Title of Tax Court and Cause.]

DESIGNATION OF PORTION OF THE REC-
ORD TO BE CERTIFIED, TITLED IN THE
TAX COURT OF THE UNITED STATES

Comes Now, the Petitioner, First National Benefit Society, and designate as the portion of the record to be certified for review, the complete record and all the proceedings and evidence in the action.

Dated this 23rd day of November, 1949.

/s/ ROBERT R. WEAVER,
Attorney for Petitioner.

Received Nov. 28, 1949, T.C.U.S.

Filed Nov. 29, 1949, T.C.U.S.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Victor S. Mersch, Clerk of The Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 28, inclusive, constitute and are all of the original papers and proceedings, including Exhibits 1-A, 2-B, 3 thru 9, inclusive, attached to, the stipulation of fact and Exhibits 10, C and D, admitted in evidence, on file in my office as the original and complete record in the proceeding before The Tax Court of the United States in the above-entitled proceeding and in which the petitioner in The Tax Court has initiated an appeal as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 7th day of December, 1949.

[Seal] /s/ VICTOR S. MERSCH,
Clerk.

[Endorsed]: No. 12433. United States Court of Appeals for the Ninth Circuit. First National Benefit Society, a corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record, Petition to Review a Decision of The Tax Court of the United States.

Filed December 20, 1949.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the
Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 12433

FIRST NATIONAL BENEFIT SOCIETY,
a Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

STATEMENT OF POINTS TO BE
RELIED UPON ON APPEAL

Comes now the First National Benefit Society, a Corporation, Petitioner in the above-entitled cause and states that the points upon which it intends to rely on appeal in this case are as follows:

1. That the Findings of Fact on file herein are not supported by the evidence,
2. That the Judgment is not supported by the evidence,
3. That the Judgment is not supported by the Findings of Fact,
4. That the Judgment is contrary to law, and
5. That the Court erred in the admission of evidence.

The reason for the statement of points included in numbers 1, 2, 3 and 4 above are briefly as follows:

I.

The Petitioner is a life insurance company within the meaning of Section 201 (a) of the Internal Revenue Act as it existed in the year 1939.

II.

The gross income of a life insurance company is defined in Section 202 of the said Internal Revenue Act as the gross amount of income received during the taxable year from interest, dividends and rents, while the evidence herein shows that Petitioner was taxed upon the addition to its reserves allocated to a mortuary fund out of premium income paid for that purpose.

III.

The evidence shows that during the year 1939, the Petitioner was engaged in the business of writ-

ing and issuing contracts of life insurance and that more than fifty per centum of its reserves were held for the fulfillment of such contracts within the meaning of said Section 201, and that said reserves were required by the statutes of the State of Arizona, and that these reserves were calculated upon an actuarial basis with assumed rates of interest and that such calculations were based upon recognized tables of mortality as required by the Treasury Department Regulation construing Section 201 (a) of the said Act for the year 1939. (Articles 201 (a)-1 and 203 (a)-1 of Treasury Regulations 101.)

The Tax Court erred in its Conclusion of Law to the effect that Petitioner did not have or maintain a "reserve fund" for the purpose of fulfilling its insurance contracts within the meaning of Section 201 (a) of the Revenue Act of 1939 as interpreted by Articles 201 (a)-1 and 203 (a)-1 of the Treasury Regulations 101, and such finding is contrary to the evidence herein.

IV.

The Tax Court erred in finding that Petitioner as a mutual insurance company, other than life, is not entitled to a deduction for a deposit made with the State Treasurer of Arizona since the reserve funds were not such as those specified in section 201(c)(1)(A). If the Petitioner is to be classified under Section 207 of the said Act it would be entitled to a deduction of those funds held to pay losses and expenses.

V.

The Tax Court erred in finding that during the taxable year, petitioner was not an assessment company and as such not entitled to deductions claimed under section 207(c)(1)(A). That if the Petitioner's reserves do not meet the qualifications of ordinary life insurance companies, then since Petitioner did nothing but a life insurance business and since its policies are required by law to provide for assessment Petitioner would be an assessment life insurance company.

VI.

The Tax Court further erred in its finding that Petitioner was not entitled to a deduction of \$4,518.71 deposited under the requirement of the State law with the Arizona State Treasurer during the taxable year, since the State Law required that this reserve be held for the fulfillment of its contracts.

VII.

The Tax Court erred in finding that the objects and purposes for which said Corporation is formed are: To engage in, conduct and carry on the business and customary activities of a mutual benefit association within the meaning and provisions of Sections 607-608-609-610 of Chapter 14 of Article 3 of the 1928 Revised Statutes of the State of Arizona, for the reason that the 1937 Arizona Benefit Corporation Act superseded the provisions of these sections, and the companies theretofore organized were required to operate under the latter statute.

VIII.

The Tax Court erred in its finding that it was proper for the Respondent to accrue losses on deaths that had occurred but were unreported at the end of the year without accruing unpaid salary claims for the same year.

Dated this 31st day of December, 1949.

/s/ ROBERT R. WEAVER,
Attorney for Petitioner.

Affidavit of service by mail attached.

[Endorsed]: Filed Jan. 4, 1950, U.S.C.A.

[Title of REDACTED Court and Cause.]

PETITIONER'S DESIGNATION OF PORTIONS OF THE RECORD TO BE PRINTED AS THE RECORD ON REVIEW

Comes now the Petitioner, First National Benefit Society and designates as the portions of the record to be printed as the record on review the following portions of the record certified by the Clerk of the United States Tax Court, to wit:

1. Docket Entries, Document No. 1 of the certified transcript of the record.
2. Amended Petition, Document No. 4 of the certified transcript of the record.

3. Entry of Appearance, Document No. 5 of the certified transcript of the record.

4. Answer to Amended Petition, Document No. 6 of the certified transcript of the record.

5. Service of Answer and Notice of Place of Hearing, Document No. 7 of the certified transcript of the record.

6. Notice of Setting Proceeding for Hearing—Circuit Cal., Document No. 8 of the certified transcript of the record.

7. Minutes of Proceedings before the Tax Court of the U. S., Document No. 9, of the certified transcript of the record.

8. Official Report of Proceedings, Document No. 10, of the certified transcript of the record.

9. Stipulation of Facts, Document No. 11, of the certified transcript of the record.

10. Joint Exhibits 1-A, 2-B, 3 thru 9, Incl. Attached to Stipulation of Facts, Document No. 12, of the certified transcript of the record.

11. Exhibits 10, C & D Admitted in Evidence, Document No. 13, of the certified transcript of the record.

12. Memorandum Findings of Fact and Opinion, Document No. 21, of the certified transcript of the record.

13. Decision, Document No. 22, of the certified transcript of the record.

14. Bond in the Amount of \$2,2771.66, Document No. 23, of the certified transcript of the record.

15. Petition for Review, Document No. 24, of the certified transcript of the record.

16. Proof of Service of Petition for Review, Document No. 25, of the certified transcript of the record.

17. Affidavit of Service of Designation of Record and Request for Preparation for the Certification of Record, Document No. 26, of the certified transcript of the record.

18. Request for Preparation for the Certification of Record, Document No. 27, of the certified transcript of the record.

19. Designation of Record, Document No. 28, of certified transcript of the record.

20. Certificate and Seal.

Dated this 31st day of December, 1949.

/s/ ROBERT R. WEAVER,
Attorney for Petitioner.

[Endorsed]: Filed Jan. 4, 1950.

[Title of Court and Cause.]

STIPULATION

It is hereby stipulated and agreed by and between the respective parties herein, through counsel, that there may be omitted from the printed record herein:

1. Joint Exhibit 1-A, being the Articles of Incorporation and the By-Laws of petitioner as both existed during the year 1939, including the amendments to the By-Laws as those existed in 1939.

2. Joint Exhibit 2-B, being blank printed forms H, XXX, XXX-GG, XX-J, XXX-FG, and AH-1, being forms of membership certificates and insurance policies typical of those issued by petitioner during the year 1939.

3. Petitioner's Exhibit 3, being a transcript of petitioner's general ledger accounts for the year 1939.

4. Petitioner's Exhibit 4, being photostatic copies of the final monthly sheets of petitioner's Receipts Journal for the year 1939 with recapitulation of amounts transferred to other accounts of the general ledger.

5. Petitioner's Exhibit 5, being photostatic copies of the final monthly sheets of petitioner's sheets of petitioner's Disbursements for the year 1939.

6. Petitioner's Exhibit 6, being a photostatic

copy of the sheet of petitioner's Disbursements Journal for the year 1939, showing closing entries for such year.

7. Petitioner's Exhibit 7, being photostatic copies of petitioner's journal for the year 1939.

8. Petitioner's Exhibit 8, being a copy of petitioner's minutes adopting the salary contract of June 30, 1937, with M. C. Reese, petitioner's president.

9. Petitioner's Exhibit 9, being a schedule of petitioner's salary contract liability to M. C. Reese, petitioner's president.

10. Petitioner's Exhibits 10, C, and D, all being in evidence.

It is agreed that any and all of these Exhibits shall be included in the printed record by reference, that the Court may so consider them, and that both parties may make whatever reference thereto on brief and an argument as may be deemed by them, or either of them, necessary, as if they had all been printed in full.

As condition to this stipulation, however, the parties agree that three copies of joint Exhibits 1-A and 2-B shall be by petitioner made available to the Court for use during consideration, argument, etc., in typewritten form.

This stipulation is based upon the fact that the amount of tax liability involved in the case does

not seem reasonably to justify any more printing than is actually necessary to the Court's convenience.

/s/ ROBERT R. WEAVER,
Attorney for Petitioner.

/s/ THERON L. CAUDLE,
Assistant Attorney General,
Attorney for Respondent.

So Ordered:

/s/ WILLIAM DENMAN,
Chief Judge.

/s/ WILLIAM HEALY,

/s/ HOMER BONE,
United States Circuit Judges.

